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Report on UNCITRAL-INSOL-IBA Global Insolvency Colloquium (Vienna, 4-6 December 2000)

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Introduction

1. At its thirty-second session (1999) the Commission had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. Recognizing the importance to all countries of strong insolvency regimes, the Commission decided to undertake further study of the relevant issues and of work already being undertaken by other organizations. To facilitate that further study, the Commission decided that one session of a working group should be held to ascertain what, in the current landscape of efforts, would be an appropriate work product and to define the issues to be included in that product. That exploratory session of the Working Group on Insolvency Law was held at Vienna from 6-17 December 1999 (for the report of that Working Group see document A/CN.9/469).

2. At its thirty-third session (2000) the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). It was noted that, in order to obtain the views and benefit from the expertise of those organizations, the Secretariat would organize a colloquium before the next session of the Working Group, in cooperation with INSOL and the IBA, as had been offered by those organizations.[1]

3. That colloquium was organized with the co-sponsorship and organizational assistance of INSOL and in conjunction with the IBA at Vienna, 4-6 December 2000. The colloquium was designed to provide a forum for dialogue among insolvency practitioners and experts, international organizations and Government representatives on the work of other organizations in the area of insolvency law reform (including the reports of the World Bank, the IMF, the ADB, INSOL and the IBA), the needs of nations either undertaking or considering undertaking reform of part or all of their domestic laws relating to insolvency and to determine the manner in which the Commission and other organizations could assist the process of reform.

4. The approximately 150 participants from 40 countries included lawyers, accountants, bankers, judges and insolvency practitioners, as well as representatives of Governments and international organizations such as the ADB, the European Bank for Reconstruction and Development (EBRD), the IBA, the IMF, INSOL and the World Bank. The main speakers included insolvency officials, judges, practitioners and representatives of organizations who have had significant experience in insolvency law and law reform initiatives.

5. Based on the exchange of views and information that took place amongst participants, the present note provides an evaluation and synthesis of the Colloquium proceedings, including a summary of key issues recommended as the basis for future work by the Commission and addressing the form that that work might take.

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[1] Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17, A/55/17, para. 408.

I. General remarks

6. The view was widely shared that, as a general objective, the Commission should strive to work out the elements of a functioning insolvency system, which would be clear and understandable by both domestic and foreign participants, which would maximize the utility of the tangible and intangible assets of an enterprise on a fair and balanced basis to the stakeholders and which would proceed without delay to avoid the erosion of value. While it was generally agreed that financial failure, absent fraud or its equivalence, should be recognized as a dynamic of a healthy competitive economy, it was recognized that the social impact and status of bankruptcy in many countries could not be overlooked.

7. It was the general view of participants that the process should be transparent and certain. That would be assisted by suitable information and disclosure standards, since information access and disclosure was important to ensure predictability of outcome and avoid delay in resolving issues. It was felt that there must be a facility to allow the debtor and the creditors of the business community and their advisers and, if insolvency occurs, the participants in the insolvency process including lawyers, insolvency practitioners, work-out managers, regulators and courts, to understand how the system works in practice and their respective roles and interactions.

8. It was generally agreed that an insolvency system should involve a liquidation channel when that was the way in which the resources of the enterprise could best be employed, with a reorganization (also referred to as rescue or rehabilitation) channel if that was viable and would result in greater value. The relationship between the two channels within the insolvency system needed to be examined with a view to achieving better integration, and the effects of commencement of proceedings considered in the context of that relationship. The analysis, for example, must address the question of the stay so that it was clear whether secured creditors were exempt or whether their enforcement rights were temporarily suspended and whether the stay applied automatically. While liquidation was recognized as being the most established channel, it was suggested that work by the Commission should focus upon establishing an effective reorganization regime, which, in any case, would involve consideration of a number of issues common to both liquidation and reorganization.

9. In terms of economic and social imperatives, it was noted that an insolvency system required an appreciation by the legislative, executive and bureaucratic arms of Government that it was demonstrably in the public interest to have a functioning insolvency regime as a means of encouraging economic development and, with that, the attainment and enhancement of social policy. It was suggested that the focus on economic and credit enhancement should be emphasized in any work undertaken by the Commission, to limit and direct the scope of the project, such focus being consistent with the Commission's mandate on international trade law.

10. The Colloquium heard that many countries in the world were studying reorganization systems, based on the growing realization that such systems were critical to both corporate and economic recovery, either in a recession or a crisis. Additionally, it was observed that it was increasingly apparent that reorganization systems, and the effectiveness with which they functioned, affected the pricing of loans in the capital market, with comparative analysis of such systems becoming both common and essential. Effective reorganization systems were also noted as being important in encouraging entrepreneurial activity and the availability of venture capital, the lack of such a system negatively impacting the availability and development of foreign capital.

11. It was noted also that the social imperatives of insolvency law must be included in any consideration of reform, since the goal of that reform should be broader than credit enhancement. The impact of bankruptcy on those involved in the process, as well as the social status that bankruptcy currently had in many countries, had the potential to strongly influence the success of implementation of insolvency law reform proposals. The social status of insolvency was particularly important where it impacted upon the extent to which insolvency processes were used and, consequently, the likelihood of that regime being implemented in a way that could achieve the economic goals of development and growth.

12. Strong support was expressed in favour of further work being undertaken by the Commission and completed as soon as possible to take advantage of the work of other organizations and the current broad interest in insolvency law reform.

II. Key elements of an effective insolvency regime

13. The key elements to be addressed by an insolvency regime were considered to include: eligibility criteria; access criteria; the bankruptcy estate; application of automatic stay; role of management; role of creditors creditors committees; treatment of contractual obligations; avoidance actions; distribution priorities; and additional issues specific to reorganization (relationship between liquidation and reorganization; business operations and financing; and provisions specific to the reorganization plan).

14. Participants noted that those key elements could not be viewed in isolation and must all interact if the insolvency system was to function smoothly and efficiently. Nor could they be developed in isolation from other relevant elements of economic and commercial law and indeed from the general fabric of a country's laws. Effective debt enforcement regimes, for example, were noted as being of particular importance to the effective operation of an insolvency regime. It was suggested that the linkages between insolvency and other laws and their importance should be highlighted and the implications of different policy options concerning those linkages recognized and considered in future work.

A. Eligibility and access criteria

15. Determination of the scope of application of an insolvency framework and the relevant eligibility criteria was noted as involving consideration of important policy questions such as whether highly regulated institutions such as banks and insurance companies should be included and the degree to which state-owned-enterprises should be included.

16. It was felt to be essential that entry criteria should be realistic and fair and take into account modern business practices. Whatever tests were to be applicable (balance sheet, cash flow or other), it was important that they should not lead to a stifling of innovation, should broadly take into consideration modern banking instruments and accounting standards and encourage a process that was quick and efficient, with recognized tests of insolvency and prompt determination as to whether the threshold for insolvency had been met. It was also observed that it was necessary for countries to consider and develop clear goals for an insolvency regime, particularly in terms of what they wanted the regime to achieve, such as early restructuring, protection of creditors, restructuring of insolvent debtors or other policy imperatives.

B. Role of management

17. Experience cited by participants suggested that an insolvency system needed to provide a flexible approach towards the role of management in any particular case. In situations where there was a fear of dissipation of assets and other adverse possibilities,

there might be a need to remove existing management immediately. In other cases, management could continue to run the day-to-day business as the most cost-efficient solution, but be supervised by, for example, a creditor- or court-appointed trustee. It was also pointed out that while the liability of management for continuing to trade whilst insolvent might be self-evident in some countries, that was not a universal principle. In addition, since the manner in which that liability was treated could provide an important incentive for management to negotiate more permanent reorganization solutions with creditors, attention should be drawn to that issue in the Commission's work.

C. Role of creditors

18. On the issue of the role of creditors, it was suggested that it might be necessary to emphasize the interests of creditors as primary stakeholders in the insolvency process. There was general agreement that there was a need to clarify and distinguish the rights of various classes of creditors, in terms of the formation of committees and the voting rights of different classes, as well as liability for participation in such committees and how such liability might be regulated or discharged.

19. Attention was drawn to the important role played by banks in ensuring credit to the economy, particularly in emerging markets and developing jurisdictions. It was suggested that while bank lending should not be treated in a special manner, modern insolvency regimes should adequately reflect the needs of bank creditors, particularly lenders in foreign currency in inflationary economies, and take account of certain currency agreements that might affect the quantum of claims by foreign exchange creditors.

D. Prevention of abuse and role of courts and regulators

20. Participants discussed the role of the court in the insolvency process, noting that one of the key functions of the court was to guide the process to ensure its integrity and fairness both in terms of participation and outcome. Oversight to prevent abuse, by management, by professionals, and in the transfer of assets, was identified as a prime function of courts in insolvency cases.

21. An issue requiring consideration at an early stage of the reform process related to the body which might be given regulatory authority over insolvency cases. It was noted that a number of countries were moving to a private sector type of agency or institution, reflecting a cultural preference for non-court guided solutions, while in others regulation of the insolvency regime was increasingly seen as a judicial function to ensure fair treatment of all parties and provide legal certainty to third parties. A further policy question was whether an effective insolvency system required specialized judges and courts. There was general agreement that it was not desirable to have insolvency cases randomly assigned to members of the general court. While a specialized court of commercially-oriented judges might not always be possible or desirable, flexibility and accessibility would frequently be enhanced if certain judges of the general court were designated to handle insolvency cases, and, to the maximum extent possible, the same judge should be involved in the continuing insolvency proceeding. It was suggested that policy considerations relating to the different regulatory alternatives should be included in the Commission's work.

E. Professional and judicial training

22. A general view of participants was that a key issue closely related to the prevention of abuse was that of the need for professional and judicial training, especially where judges performed critical supervision and decision functions with respect to insolvency proceedings. It was noted that for an insolvency law to be effective it must be able to be deployed against an effective operational infrastructure. While it was widely recognized that the Commission could only play a limited role with respect to such training, it was felt

that it might have a role to play in conveying a message to policy makers and the insolvency community that, for an insolvency system to work, it was not enough simply to have the laws in place, but that the training of professionals was essential.

23. There was general support for the view that it was desirable for judges dealing with insolvency matters to have an approach based upon a commercial mentality and awareness, that they should not only rely upon their own skills and experience, but know now, and when, to rely upon the business expertise and experience of others involved as the case. It was also desirable for judges to have developed experience in dealing with insolvency proceedings and their special needs, including knowing when to allow the affected parties the opportunity to negotiate outside the court, even with a pending court matter.

24. It was recognized as desirable that the court should be able to be accessed on a timely basis as required, so that matters requiring solution were treated as a priority to enable the insolvency system to function effectively and efficiently. Appeal time should be kept to the minimum, consistent with fairness to the affected parties. The appeal court, especially if it did not have the functional expertise of the lower court, should come to appreciate that reversal, in whole or in part, should rarely occur and only when there was a true miscarriage of justice.

25. Appropriate selection of judges on merit and ability and a regime where judges had economic security and were accountable on objective standards of good behaviour, including non-corruptibility, were widely seen as important to ensuring the neutrality and independence of judges and the development and maintenance of the tradition of the rule of law.

26. Amongst the suggestions for things most needed to assist with training were guidelines and allocated resources to assist courts, implementation guides for insolvency administrators, the establishment of training centres, coordination of training to avoid unnecessary duplication and appropriate channelling of resources. There was also a suggestion that future work on insolvency law and infrastructure should include a self-funding mechanism to ensure that training would be sustainable and continuous.

F. Restructuring alternatives

27. It appeared to participants that it would be advantageous to have a system which encouraged the parties to avoid the delay of a formal court proceeding over an extended period of time, which provided alternative processes to assist in and facilitate the rescue of capital at an early stage, and which might be more cost effective than formal proceedings. It was suggested that while such a system worked best where there was a functional law and infrastructure that could ensure certainty of outcome, it was also useful where the institutional framework was not effective.

28. Work by the INSOL Lenders Group on the "Statement of Principles for a global approach to multi-creditor workouts" was introduced. The Principles were designed to expedite rescues, and therefore increase the prospects for success, by providing guidance based on experience, so that debtors and creditors could move the process to a resolution speedily and in a relatively structured manner. It was noted that the Principles were most likely to facilitate workouts where there was an appropriate legal, regulatory and governmental policy framework. The existence and prospective implementation on a consistent basis of a well-designed insolvency law, by providing financial creditors with effective means of recourse against uncooperative debtors, encouraged debtors to cooperate with those creditors with a view to negotiating an agreement outside a formal insolvency in an acceptable timeframe. The formulation of the Principles was welcomed. There were suggestions, however, that the Principles might not go far enough and that something more might be required to ensure that out-of-court agreements were implemented. A further

proposal was made to have introduced into the insolvency system an accelerated procedure to implement a work-out plan that was not fully consensual, but that was endorsed by the vast majority of creditors. The plan would be processed through a court (being a court administering insolvency cases) with a view to binding the dissenting minority, provided that it met certain objective criteria specified in the insolvency law. It was widely felt by participants that in-depth analysis would be required in order to decide whether such a proposal should be pursued within the scope of the work on insolvency that the Commission might undertake.

G. UNCITRAL Model Law on Cross-Border Insolvency

29. Strong support was expressed in favour of countries adopting the Model Law as soon as possible. In support of early adoption, it was suggested that it be made clear that any future work on insolvency law undertaken by the Commission would in no way add to or seek to modify the existing text of the Model Law.

III. Form of possible future work

30. It was generally agreed by participants that, given the complexity of the interrelationship between an insolvency law and the other national laws, as well as the policy issues related to social and economic concerns, a single model law was neither feasible nor desirable. In addition, the fact that the reform process was a continuing one and that there was a strong need to take account of changing economic and policy considerations underscored the desirability of a flexible work product, designed around key elements of an effective insolvency regime.

31. It was suggested that future work should include three key areas. The first would reflect the key component of the reports from international organizations (the World Bank, the IMF and the ADB), setting out the core elements of an effective insolvency regime and considering alternative policy options and approaches to the different issues identified, including the impact of social and economic factors.

32. The second area would be a comparative analysis of some of the provisions and precedents that are already in existence in national legislation and international instruments, including, where appropriate, experience with those provisions, to the extent that that experience might be relevant in assisting legislators to make choices between different policy options.

33. The third part would set forth suggested legislative provisions or recommendations or outlines of such provisions, including the essential issues to be addressed. The form which that third part might take would depend upon the topic under consideration; as was noted in the discussion at the Colloquium, some of the key elements might lend themselves to formulating draft model provisions because they reflected a more or less general consensus that a particular approach should be taken. Where that was not the case, the key elements or the key points that should be addressed to deal effectively with certain topics could be formulated.

IV. Conclusions

34. Broad support was expressed by participants in favour of the Commission undertaking work (in the form outlined in paragraphs 30-33 above) on the key elements of an effective insolvency regime, as identified in paragraph 13 above. While the Working Group was requested to proceed with that work as expeditiously as possible, the Colloquium strongly recommended that approximately 6 months be allowed for thorough preparation of drafts for consideration by the Working Group. It was noted also that the

mandate given by the Commission to the Working Group[1] referred to the work underway or already completed by other international organizations and required the Working Group to commence its work after receipt of the reports currently being prepared by other organizations, including the World Bank. The Colloquium heard that the World Bank report was expected to be finalised in early 2001.

35. In light of these factors, the meeting of the Working Group originally scheduled for 26 March to 6 April 2001 at New York has been rescheduled for 23 July to 3 August 2001 at New York. A further Working Group meeting might take place in December 2001 at Vienna.

36. In light of the mandate given to the Working Group,[2] the Commission might wish to take note of this report and request the Working Group to proceed with its work expeditiously.

[1] Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17, A/55/17, para. 408. The terms of the mandate are based on the recommendation of the Working Group set forth in document A/CN.9/469, para. 140.

[2] ibid.